REGULATORY FLEXIBILITY COMMITTEE

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MEETING MINUTES[1]

Meeting Date:	**August 22, 2001**
Meeting Time:	**1:30 P.M.**
Meeting Place:	**State House, 200 W. Washington St., House Chambers**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**1**

Members Present: **Rep. Craig Fry, Co-Chairperson; Rep. Jack Lutz; Rep. James Atterholt; Rep. Robert Behning; Rep. David Frizzell; Rep. Daniel Dumezich; Rep. David Crooks; Rep. Richard Bodiker; Rep. Susan Crosby; Rep. Brian Hasler; Rep. Scott Pelath; Sen. Greg Server, Co-Chairperson; Sen. Beverly Gard; Sen. James Merritt; Sen. Becky Skillman; Sen. Thomas Weatherwax; Sen. Timothy Lanane; Sen. Glenn Howard; Sen. James Lewis; Sen. Frank Mrvan.**

Members Absent: **Rep. David Yount; Rep. Ed Mahern; Rep. Paul Robertson; Sen.**

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[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.ai.org/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Murray Clark; Sen. Connie Lawson.

Representative Craig Fry and Senator Gregory Server, Co-Chairmen of the Regulatory Flexibility Committee, convened the meeting at 1:30 p.m. and asked members of the Committee to introduce themselves. Representative Fry then invited Chairman William McCarty of the Indiana Utility Regulatory Commission (IURC) to present the IURC's annual report to the Committee on telephone services.

Annual Report on Telephone Services[2]

Chairman McCarty indicated that he would address the following issues: (1) local exchange competition; (2) broadband services; and (3) the IURC's need for enforcement authority.

(1) Local Exchange Competition

Chairman McCarty reported that competitive local exchange carriers (CLECs) increased their market share of statewide local telephone lines in 2000. The CLEC market share grew from 1.4% to 8% of the total market from January to December 2000. This growth in the CLECs' share constituted 69% of the total growth in local access lines. However, Chairman McCarty pointed out that the increase in market share was largely attributable to a few CLECs providing service to select business customers in large metropolitan areas. The IURC's survey found that in the residential consumer market, competitors have acquired only 2.2% market share. In contrast, Chairman McCarty reported that five years after the long distance market was opened to competition, competitive carriers had achieved 25% market penetration.

Chairman McCarty next explained that there were three main ways for CLECs to enter the market: (1) by constructing and using their own facilities; (2) by reselling incumbent local exchange carrier (ILEC) services; and (3) by using unbundled network elements (UNEs) leased from other carriers. According to Chairman McCarty, the most growth occurred in CLEC-owned facilities. However, he noted that most of these facilities-based CLECs operated in Hamilton and Marion Counties. He predicted that Vanderburgh County would likely experience CLEC growth in the near future due to the emergence of AT&T and a phone company spinoff by a local electricity provider.

Noting that competition most often occurs in highly populated and metropolitan areas, Chairman McCarty reported that of the five states served by Ameritech (Illinois, Indiana, Michigan, Ohio, and Wisconsin), Indiana ranks fourth in total population and fifth in terms of the percentage of people who live in large metropolitan service areas.

(2) Broadband Services

The IURC's report indicates that high speed Internet service is just beginning to become a viable competitive option for consumers. Of the 20 companies currently offering broadband services in Indiana, 12 are CLECs and 8 are ILECs. However, the availability of most of these services is limited to large metropolitan areas. Only 25 of 566 wire centers are equipped to offer digital subscriber line (DSL) service. Furthermore, cable TV companies are just starting to enter the high speed Internet market. There is no current Indiana data on use of either voice over cable or voice over IP and its impact on basic local telephone service.

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[2] See Exhibit 1.

(3) IURC's Need for Enforcement Authority

Chairman McCarty concluded that the potential for a competitive local telephone market exists in Indiana, but that there is still much progress to be made. He emphasized that in order for competition to become a reality, the IURC needs the authority to enforce rules concerning both quality of service and anticompetitive acts. He explained that such enforcement authority must include the ability to impose meaningful penalties on companies that violate these rules. He noted that Illinois has given its regulatory agency increased authority to enforce quality of service standards and rules against anticompetitive acts. After calling on Indiana legislators to grant the IURC similar authority, Chairman McCarty opened the discussion to questions from members of the Committee.

Senator Gard asked about the use of a "rocket docket" in certain cases and disputes that come before the IURC. Chairman McCarty explained that the IURC's orders may be appealed in court, and that appeals sometimes slow the final resolution of cases. He noted that an expedited docket is a method the IURC can use to more quickly resolve cases and disputes and bring about a final order. However, he stressed that without the availability of meaningful penalties, the orders that result from the expedited process are often unenforceable.

Senator Server then asked whether the slower growth in competition in the local residential market compared to the local business market was due to the fact that residential telephone rates are lower than those for businesses. He wondered if it is reasonable to expect competitive growth in the local residential market if the financial incentives to provide residential services are comparatively weak. Chairman McCarty responded that he would not advocate an initial increase in residential rates on the theory that as more providers enter the market, the rates would eventually be driven back down. He suggested that CLECs may be able to profitably enter the residential market by offering bundled services.

Representative Lutz asked whether Chairman McCarty had any suggestions for improving competition in the local residential market. Chairman McCarty repeated that competition depends on the IURC having enforcement powers with respect to anticompetitive acts in the market. He told Committee members that "time is of the essence" in granting the IURC these powers.

Representative Crosby then inquired about improving access to telecommunications services in rural areas of the state. Chairman McCarty indicated that some of the settlements the IURC has reached with local exchange carriers provide for services to rural areas. He suggested that a possible legislative solution would be the creation of a state universal service fund. A state program would supplement the Federal Universal Service Fund (USF), which provides assistance to small companies serving rural, insular, and high cost areas. According to Chairman McCarty, 16 states have established universal service funds.

Senator Lanane asked whether the IURC was discovering evidence of anticompetitive acts by ILECs. Chairman McCarty replied that the IURC had received reports of delays in the amount of time taken to switch lines from one provider to another. However, he pointed out that the evidence of anticompetitive behavior is largely anecdotal, consisting mainly of complaints from consumers.

Testimony from CLECs

After Chairman McCarty concluded the IURC's annual telephone report, Representative Fry invited testimony on Senate Resolution 30, which directs the Committee to review competition in the local telephone market.

(1) Time Warner Telecom[3]

Pamela Sherwood, Vice President of Regulatory for Time Warner Telecom, addressed the Committee first. Ms. Sherwood noted that Time Warner Telecom is a facilities-based CLEC that lays its own fiber and uses its own network to serve customers.

Ms. Sherwood explained that the federal Telecommunications Act of 1996 (TA 96) created a framework for local telecommunications competition and was modeled after the deregulation of the long distance industry. TA 96 was designed to allow ILECs to enter the long distance market upon achieving the goal of local competition. In Indiana, the three largest ILECs, with market opening ability, are Ameritech/SBC, GTE/Verizon, and Sprint/United. However, according to Ms. Sherwood, these ILECs have delayed implementation of TA 96's market opening requirements through litigation, appeals, and inferior wholesale service to CLECs.

Although Time Warner Telecom has limited its reliance on ILECs by building its own network, it still depends on ILECs for some of its network. Ms. Sherwood told the Committee that quality of service problems have occurred because the ILECs that serve as wholesale suppliers to Time Warner also are its primary competitors in the resale market. According to Ms. Sherwood, ILECs have provided poor wholesale service to Time Warner Telecom by losing orders and missing due dates for installing and repairing service. Ms. Sherwood then provided examples of problems with some of the wholesale services provided by Ameritech. Because of these problems with the wholesale services it receives, Ms. Sherwood explained, the service that Time Warner Telecom can provide to its customers suffers in turn.

Ms. Sherwood also noted that ILECs continue to merge, allowing them to maintain their market share. At the same time, many CLECs are facing bankruptcies, missed revenue targets, and employee layoffs. Ms. Sherwood pointed out that in response to this current market situation, neighboring states have taken steps to promote local competition. For example, Illinois has passed legislation that raises the penalties the Illinois Commerce Commission can levy against providers that defy its orders. Such penalties are based on a percentage of a provider's gross annual intrastate revenues. In Wisconsin, legislation has been proposed that would allow the state's Public Service Commission to employ "structural separation" if an ILEC violates market opening provisions. Structural separation would allow the Commission to separate the offending ILEC's wholesale and retail components into separate divisions.

Ms. Sherwood concluded by stressing that the IURC needs greater enforcement authority and the ability to establish penalties for poor wholesale performance.

(2) KMC Telecom

Lynn Knapp, City Director of KMC Telecom in Fort Wayne, spoke to the Committee about the challenges facing his company. Mr. Knapp informed the members that KMC is a CLEC serving 37 markets nationally, including more than 500 business customers in Fort Wayne. He explained that business customers seek both competitive prices and better

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[3] See Exhibit 2.

service from CLECs.

According to Mr. Knapp, KMC, like most CLECs, typically enters local markets at a loss. KMC entered the Fort Wayne market at a loss of between $2,000,000 and $3,000,000. Because it is not a facilities-based CLEC, KMC must reapply every 30 days for use of available facilities. Mr. Knapp expressed frustration that Verizon, the ILEC in its Fort Wayne market, has preferred charging a more expensive access tariff rather than allowing KMC to lease UNEs. Mr. Knapp also reported that Verizon has made errors in publishing the phone book entries and yellow page ads that KMC sends to Verizon on behalf of KMC customers. As a result of these errors, KMC has received complaints from businesses that have lost money as a result of advertisements not being published. Finally, Mr. Knapp told of conversion delays faced by customers who switch from Verizon to KMC.

(3) American ISP Association

Sue Ashdown, Executive Director of the American ISP Association, began her testimony by confirming that as customers of CLECs, Internet Service Providers (ISPs) have indeed lost business as a result of the yellow page errors described by Mr. Knapp of KMC. Ms. Ashdown then described the current discrimination faced by independent ISPs from ILECs. According to Ms. Ashdown, ILECs tend to favor their own in-house ISPs while denying access to competitive ISPs. Because ISPs depend on phone lines to reach their customers, their ability to stay in business is threatened when access to those lines is denied. This, in turn, hurts the CLECs that lose independent ISPs as customers. Ms. Ashdown also mentioned the similar discrimination ISPs have experienced as ILECs deploy DSL services.

Ms. Ashdown expressed regret that the ultimate result of a discriminatory market is the loss of choice for consumers. She predicted that eventually only large ISPs will remain if current market conditions continue.

(4) Midwest Telecom of America

James Smutniak, Vice President of Midwest Telecom of America, briefly testified about his company's failed attempts to develop strategic partnerships with ILECs. A Merrillville-based company serving business customers primarily in the northern half of the state, Midwest Telecom has encountered problems with wholesale services it receives in both its Ameritech and Verizon service areas. Mr. Smutniak gave specific examples of some of these problems and urged legislators to give the IURC the authority to issue fines for anti-competitive acts by ILECs.

(5) MCI WorldCom

Joan Campion of MCI WorldCom told the Committee that her company cannot enter the local residential telephone market in Indiana until it becomes economically feasible to do so. She testified that MCI WorldCom has long been involved in providing long distance and local business service. However, she stated that until the IURC has adequate enforcement authority, competition in the local residential market is unlikely to become a reality in Indiana.

Ms. Campion explained that MCI WorldCom faced the same problems in Michigan that Mr. Knapp of KMC described as happening in Fort Wayne. Like KMC, MCI WorldCom encountered ILECs that were willing to charge tariffs to allow CLECs to buy access facilities, but were unwilling to lease UNE facilities. However, MCI WorldCom was able to remain competitive in Michigan due to the enforcement authority that the state has over offending ILECs.

Ms. Campion suggested that change has to occur at the state level for residential competition to succeed. She explained that MCI WorldCom has even been able to enter the residential local market in states where the Bells are not yet allowed to provide long distance service. In such states, controls on wholesale pricing have been critical to MCI WorldCom's ability to compete. Ms. Campion noted that MCI WordCom provides local residential service in New York, Texas, Pennsylvania, Illinois, Michigan, and Georgia.

Ms. Campion told the Committee that MCI WorldCom needs a workable operations exchange system in Indiana to be able to provide local residential service. She suggested that if change does not occur in the state, there will be a re-monopolization of the local market.

After Ms. Campion concluded her testimony, Representative Bodiker asked Mr. Knapp of KMC about the percentage of KMC's business that involves providing residential service. He also inquired as to KMC's strategy for the next five years. Mr. Knapp replied that KMC had decided in 1995 to pursue business customers only. He stated that because obtaining facilities for residential service remains a problem, KMC has no current plans to enter the residential market.

Representative Crooks then asked whether CLECs were interested in entering the long distance market. Ms. Campion noted that there is diminished interest because the long distance market itself is shrinking, due to the emergence of cell phones, e-mail, and other new communications technologies.

Senator Lanane asked whether there were any statistics on the facilities problems faced by CLECs, or whether evidence of such problems was strictly anecdotal. In response, Mr. Knapp indicated that 37% of KMC's Fort Wayne network is served from remote offices, which leads to facilities problems. He noted that nearly every industrial park served by KMC is served through a remote office.

(6) AT& T

David Doty, Vice President of Government Affairs for AT&T, discussed what other Midwestern states have done to improve competition in the local telephone market. Mr. Doty first described a new telecommunications law passed by the Michigan legislature in 2000. Mr. Doty explained that the new law was enacted after the legislature revisited a 1995 law that took away much of the state Public Service Commission's authority to regulate ILECs. According to Mr. Doty, the legislature found that there were high consumer prices, service quality problems, and a lack of competition in the local market after the 1995 act. Consequently, the Michigan legislature gave the Commission new enforcement and market opening powers in the 2000 act.

Similarly, the Illinois legislature this year gave the Illinois Commerce Commission (ICC) increased authority over ILECs. For example, the legislature increased fine levels from $2,000 per day to $250,000 per day. It also gave the ICC power to issue cease and desist orders and to award damages, costs, and attorney's fees. According to Mr. Doty, one of the most important elements of the new law was a direction to the ICC to require ILECs to provide interconnection, collocation, and network elements in order to implement competition. Mr. Doty concluded by urging Indiana legislators to study the Illinois legislation and enact similar market-opening provisions.

<u>Testimony from Telecommunications Associations</u>

After the CLECs concluded their testimony, Representative Fry invited representatives from national and state telecommunications associations to address the Committee.

(1) United States Telecom Association[4]

Porter Childers, Executive Director of Legal and Regulatory Affairs for the United States Telecom Association, spoke to the Committee about recent reports from the Federal Communications Commission (FCC). Mr. Childers first discussed the FCC's May 2001 report on local telephone competition. That report revealed that the share of the local telephone market held by CLECs grew 93% from January to December 2000. CLECs reported serving 8.5% of the national local telephone lines at the end of 2000, compared to 4.4% of the nationwide lines at the end of 1999. The report also showed that the states in which ILECs had won long distance approval demonstrated the greatest competitive activity. For example, in New York, where the FCC approved Verizon's long distance application, CLECs captured 20% of the local market. The number of CLEC lines in the state increased 130% from December 1999 to December 2000. Similarly, in Texas, where the FCC authorized SBC's long distance application, CLECs captured 12% of the local market, and the number of CLEC lines increased 60% from June to December 2000.

The local telephone report indicated that 60% of CLEC lines serve medium and large business, institutional, and government customers, while 20% of ILEC lines serve such customers. Meanwhile, 4.6% of CLEC lines serve residential and small business customers. However, the CLECs' share of this market grew nearly 45% during the last six months of 2000.

Next, Mr. Childers highlighted the FCC's July 2001 report on commercial mobile radio service competition. As of December 2000, the wireless communications industry estimated that it had over 109.5 million subscribers, which represents a 29% increase over the 86 million subscribers reported in December 1999.

Mr. Childers indicated that most customers are able to choose from at least six different mobile providers. He pointed out that wireless service is no longer a complement to wireline service but has become a preferred method of communication. For example, a survey by the Yankee Group revealed that about 3% of mobile subscribers rely on their wireless phone as their only phone. Mr. Childers also noted the emergence of mobile internet access services. He reported that since late 1999, seven major mobile telephone providers have begun offering mobile data service.

Finally, Mr. Childers shared some of the findings from the FCC's August 2001 report on high-speed Internet access. According to the report, high-speed lines connecting homes and businesses to the Internet increased 63% during the second half of 2000, resulting in a total of 7.1 million lines in service. During that period, high-speed connections over coaxial cable systems (cable modem service) increased 57% to 3.6 million lines. Also during the second half of 2000, asymmetric digital subscriber lines (ADSL) increased by 108% to 2 million lines. Mr. Childers told the Committee that the second and third largest numbers of high-speed lines were reported in New York and Texas, respectively.

After hearing these statistics, Senator Gard asked Mr. Childers whether New York and Texas have any statutes or rules that have allowed better penetration of the market for both local phone services and high-speed Internet access. Mr. Childers reiterated that the FCC's approval of ILEC long distance applications has been crucial to competition in those

[4] See Exhibit 3.

states.

(2) Indiana Telecommunications Association

John Koppin, President of the Indiana Telecommunications Association, next spoke about the state of competition in Indiana's local telephone market. Maintaining that competition is robust, Mr. Koppin pointed out that there has been 4% growth per year in CLEC access lines. Meanwhile, Verizon and SBC have reported a loss in local access lines. Mr. Koppin suggested that these losses by the ILECs are a result of competition. Noting that the infrastructure for competition is in place, Mr. Koppin argued that it has been the choice of CLECs not to compete.

Mr. Koppin also emphasized that the local exchange market as a whole is shrinking, due to increased use of wireless services. Noting that local service revenues made up only 15% of total telecommunications revenues last year, Mr. Koppin contended that regulatory efforts should be focused less on the local exchange market. He maintained that technological change is outpacing the current regulatory environment and that a new approach to regulation is needed.

Addressing the complaints raised by CLECs, Mr. Koppin observed that Ameritech had already admitted to and remedied its service problems from 2000. As to the complaints about inferior wholesale service by ILECs, he noted the complexity of the forms involved in switching customers from one provider to another. He urged the IURC to evaluate wholesale problems individually, rather than proposing legislation.

After Mr. Koppin's presentation, Senator Gard pointed out that the Indiana Telecommunications Association has three large ILECs among its members. Stating that she was amazed by Mr. Koppin's testimony, Senator Gard indicated that CLECs have complained to her that in dealing with ILECs they encounter problems on an almost daily basis.

Testimony from the Citizens Action Coalition[5]

Mike Mullett from the Citizens Action Coalition began his testimony by stating that he agreed with the local competition statistics reported by Chairman McCarty. While he conceded that the number of CLEC lines is growing, he emphasized that the growth mainly has benefitted business customers. According to Mr. Mullett, there is a wide discrepancy in the local telephone choices available to the multinational business customer versus the rural residential customer. He also stressed that competition is not an end in itself, but a means to an end. Namely, competition is a means to achieving lower prices, better service, and more choices for consumers.

Mr. Mullett contended that Indiana citizens have seen the relaxed or alternative regulation of ILECs more than they have seen actual competition in the local phone market. He suggested that the state seek a blend of competition and regulation.

Mr. Mullett then discussed service statistics for Ameritech during 2000. As an example, he cited the statistic that 10,000 customers experienced a seven-day service loss during the year. He contrasted this statistic with the IURC's service standard that calls for repairs within one day of a customer's loss of service. Mr. Mullett then provided data on

[5]See Exhibit 4.

Ameritech's restoration of out-of-service conditions, installation of primary service, and answer times for calls to the company's business office and repair center.

Mr. Mullett concluded by suggesting that consumers do not benefit from voluntary agreements between the IURC and ILECs. Mr. Mullett argued that such agreements result in lower service quality standards and inadequate penalty provisions.

Concluding Remarks from the IURC

With all other testimony concluded, Representative Fry asked Chairman William McCarty of the IURC for closing remarks. Chairman McCarty repeated his belief that anticompetitive acts are occurring in Indiana's local telephone market. He again urged lawmakers to give the IURC the enforcement authority needed to discourage and penalize such acts.

Representative Fry and Senator Server adjourned the meeting at approximately 4:30 p.m.